Agenda Dates: 12/20/00
Agenda Items: LSE

STATE OF NEW JERSEY

Board of Public Utilities

Two Gateway Center
Newark, NJ 07102

IN THE MATTER OF THE PETITION OF ATLANTIC CITY ELECTRIC COMPANY FOR APPROVAL OF THE TRANSFER OF NON-UTILITY THERMAL ENERGY FACILITIES TO THERMAL ENERGY LIMITED PARTNERSHIP I	<u>ENERGY</u> ORDER CONDITIONALLY APPROVING TRANSFER DOCKET NO. EM00060384

(SERVICE LIST ATTACHED)

BY THE BOARD:

This Order memorializes and provides the reasoning for the actions taken by the Board of Public Utilities ("Board") in this matter, by a vote of three Commissioners, at its December 20, 2000 public agenda meeting.

By letter petition dated June 27, 2000, Atlantic City Electric Company ("ACE") requested approval of the Board to transfer certain non-utility property to an affiliated company, Thermal Energy Limited Partnership I ("TELP"). Specifically, ACE seeks Board approval to transfer its Bayside Thermal Facility ("Bayside") to TELP. ACE further seeks Board approval to lease certain real property, on which Bayside is situated, to TELP for the remainder of Bayside's useful life. ACE has requested expedited approval of its petition, as well as the waiver of any requirements that the Board may find are applicable absent waiver.

ACE is a wholly owned subsidiary of Conectiv, a registered holding company under the Public Utility Holding Company Act of 1935. Conectiv also owns 100% of Conectiv Services, Inc., the parent company of Conectiv Thermal Services, Inc. ("CTS"). ACE asserts that CTS is engaged directly, and through its subsidiaries, in the business of developing and operating thermal systems for production and sale to business and institutional energy users, and that CTS owns 100% of TELP.

According to ACE, Bayside was constructed on a portion of ACE's existing Missouri Avenue property in Atlantic City, New Jersey, between 1994 and 1996 pursuant to the terms and conditions of a Service Agreement, dated November 30, 1993, between the Company and the New Jersey Sports and Exposition Authority ("NJSEA"), as amended by a subsequent agreement ("First Amendment"), dated March 9, 1995. Bayside is primarily comprised of boilers, chillers and related equipment utilized to provide thermal, i.e., heating and cooling, services to NJSEA's convention center located across the street from ACE's property. The Service Agreement has a term of thirty (30) years, commencing August 1, 1996 and ending August 1, 2026.

ACE asserts that the proposed transfer is part of an overall restructuring of a set of agreements involving Bayside and NJSEA that is estimated to provide substantial financial benefit to NJSEA, while insulating ACE from any future liability associated with its existing long-term obligation to serve NJSEA under the existing and restructured agreements. ACE further asserts that Bayside, while owned by ACE, has never been reflected in the ACE's regulated rates, is carried on the ACE's books as non-utility property, and is used to provide thermal services that are not subject to regulation by the Board.[1] ACE also asserts that it has not been, and is not, seeking recovery from the Company's customers of any costs associated with Bayside. In furtherance of its assertion, ACE submitted a certified copy of a resolution by its board of directors authorizing the transfer of Bayside to TELP, and indicating that Bayside is not now or prospectively used or useful for utility purposes.

Pursuant to the terms of an Assignment and Assumption Agreement, dated May 1, 2000, between ACE and TELP, and agreed to by NJSEA, NJSEA has consented to the assignment of the Service Agreement, as amended, between itself and ACE, to TELP. In connection with the proposed transfer, ACE and NJSEA have also implemented two amendments to the Service Agreement ("Second Amendment" and "Third Amendment", respectively), also dated May 1, 2000, which, among other things, reduce NJSEA's cost of thermal services at the convention center. The continued effectiveness of the Third Amendment was contingent upon the receipt of a final and non-appealable Board Order on or before September 1, 2000, the effective date of the Third Amendment. On July 31, 2000, ACE and NJSEA entered into an additional amendment to the Service Agreement ("Fourth Amendment") extending the effective date of the Third Amendment to December 31, 2000.[2]

ACE maintains that neither it nor TELP owns any securities of the other, and that neither is a subsidiary, directly or indirectly, of the other. ACE further maintains that it does not guarantee the debt or obligations of TELP. ACE also maintains that it and TELP are not engaged in joint ventures or partnerships together. ACE asserts that, because Conectiv owns TELP through subsidiaries, TELP is a "related competitive business segment of a public holding company" as defined in the Electric Discount and Energy Competition Act ("EDECA" or "Act"), N.J.S.A. 48:3-49 et seq.

According to ACE, the consideration for transfer will equal the net book value of Bayside at the time of transfer. ACE asserts that the net book value was $3,499,000 as of May 1, 2000. ACE submitted a proposed journal entry to record the transaction with a description of Bayside, showing that Bayside has been carried on ACE's books as non-utility property. ACE also submitted an independent appraisal of the property that indicates a current calculated value of $3,355,047. ACE asserts that the consideration for Bayside is fair and reasonable, within the scope of the appraisal, and represents the full value of Bayside.

In addition to, and coincident with, the above transfer, ACE proposes to lease to TELP, through a Lease and Common Facilities Agreement ("Lease Agreement"), certain real property upon which Bayside is situated. Said property is currently in ACE's regulated rate base and is included in the Company's utility rates. The proposed monthly consideration is $3,750, or $45,000 per year, in addition to taxes. The Lease Agreement also grants TELP certain

[1] As discussed below, it should be noted that the property on which the Bayside facility is situated is in ACE's regulated rate base and is included in the Company's utility rates.

[2] Subsequent to the Board's consideration of this matter at its December 20, 2000 public agenda meeting, ACE and NJSEA have since extended the effective date through a series of additional amendments. The effective date is currently December 31, 2001.

easements and access to common facilities necessary to operate and maintain the Bayside facility.

As described in the letter petition, and as more fully developed through responses to discovery by Board Staff ("Staff") and the Division of the Ratepayer Advocate ("Advocate"), ACE asserts that the book value of Bayside is based upon an as-built cost of $10,292,936, reduced by contributions in aid of construction by NJSEA in the amount of $2,879,939, a reserve/write off of approximately $3,000,000 borne by ACE's shareholders, and depreciation in the approximate amount of $914,000, resulting in the aforementioned book value of approximately $3,499,000. ACE also asserts that the lease rate for the real property was established based upon a sale of adjacent property that sold for about $22.95 per square foot. ACE asserts that the market value of the Bayside property was calculated by multiplying the sales value by a commonly used lease factor of 4.5%, multiplied by the number of square feet in the lease, resulting in a fair market value of $44,666 per year, or $3,722 per month. The actual lease rate is $45,000 per year, or $3,750 per month, slightly above the calculated fair market value.

On August 30, 2000, a discovery conference was held at the Board's offices and was attended by ACE, CTS, NJSEA, Staff and the Advocate. By letter dated September 1, 2000, ACE supplemented its letter petition to provide additional information in support of its request for Board approval. In its supplemental letter, ACE asserted that, since the commencement of its operations in 1996, Bayside has been operating at a loss to the Company.

In its supplemental letter, ACE also asserts that a waiver of the advertising and bidding requirements, as set forth in N.J.A.C. 14:1-5.6(b), is appropriate. ACE asserts that: (1) Bayside was constructed and operated solely to meet the contractual thermal requirements of NJSEA; (2) NJSEA has the right to refuse an assignment of the Service Agreement to any unaffiliated third party;[3] (3) Bayside has little more than salvage value, except in the context of the Service Agreement with NJSEA, thereby rendering a bid process useless, and (4) NJSEA has expressed a strong interest and desire that all of its thermal services be provided by TELP. ACE further asserts that, pursuant to the provisions set forth in N.J.A.C. 14:1-5.6(i), the proposed transfer of Bayside meets all specific waiver criteria, with the exception of N.J.A.C. 14:1-5.6(i)(6), which requires that there be no relationship between the parties other than that of transferor and transferee. Since ACE and TELP are affiliated entities, the Company has requested a waiver of this provision. ACE asserts that the basis for this waiver request is NJSEA's contractual right to refuse an assignment of the Service Agreement to an unaffiliated third party without NJSEA's consent. ACE asserts that the Service Agreement required participation of an affiliate of ACE to achieve the benefits of a restructured Service Agreement, which necessitated TELP's direct participation in the transfer process.

ACE also asserts that, separate from the instant petition but directly related thereto, its parent company, Conectiv, decided in early 2000 to sell its thermal services business. Conectiv employed an investment banking firm to conduct a bid process to sell its thermal services in New Jersey, Delaware and Nevada. The Company asserts that, of nine potential bidders identified and solicited, two bids were received in May 2000, resulting in the sale of Conectiv's

[3] Article 19(G) of the Service Agreement provides that, "Except as provided within this Article, neither party may assign its rights or delegate its performance under this Agreement without the prior written approval of the other, and any attempted assignment or delegation without such consent shall be void." Article 19(G) further provides that, "ACE may, upon notice to NJSEA, assign or transfer its rights and obligations herein to a related company whether a subsidiary of Atlantic City Electric Company or a subsidiary of Atlantic Energy, Inc. [now Conectiv]"

Nevada thermal operations in August 2000. A second bid solicitation for the remaining thermal operations occurred in July 2000, with three bids received.

Staff's review of ACE's pro forma accounting journal entries used to record the transfer of Bayside, identified several deficiencies as to the proposed accounting treatment associated with the transfer of the Bayside facility. Specifically, Staff determined that the journal entries overstated assets on the ACE's balance sheet by $3 million. On September 5, 2000, revised journal entries were submitted which correctly record the transfer. Based on its review, Staff has concluded that the revised journal entries are in accordance with the uniform system of accounts prescribed for electric utilities, with the amounts now charged to loss on disposal of plant and credited to non-utility property – fair value reserve.

Staff's review also found that ACE charged a loss to utility operating income in the amount of $3 million, while crediting a gain to total other income in the amount of $3 million. The effect of this accounting treatment would be an understatement of the Company's utility operating income and the potential for certain tax consequences to ACE resulting from the transfer of Bayside. ACE acknowledged this error in a letter received on September 21, 2000, wherein the income treatment was properly recorded as a debit of $3 million to loss on disposition of property – non-utility operating income.

By letter dated November 3, 2000, the Advocate submitted its comments concerning the letter petition. The Advocate does not oppose the transaction, noting that the transaction would provide benefits to NJSEA, with little potential for benefit to customers if the property were to remain with ACE. The Advocate has reserved its right to examine the ratemaking and accounting treatment associated with the sale of Bayside in ACE's next base rate case or other appropriate proceeding. The Advocate also notes that, while the restrictions in the Service Agreement between ACE and NJSEA serve to limit the number of potential buyers, ACE should have sought a waiver of the Board's bidding requirements prior to the initiation of the sale process.

Discussion and Findings

Pursuant to N.J.S.A. 48:3-7, no public utility shall "sell, lease... or otherwise encumber" its property without the approval of the Board. Furthermore, N.J.S.A. 48:3-55(d) requires Board approval for the transfer of an electric public utility's assets from a utility to a public utility holding company when the transfer is made other than in the ordinary course of business, and that such transfer must be recorded at full value. The implementing regulations describe the detailed material to be submitted as part of a petition for approval of a sale or lease by a utility of real or personal property.

Pursuant to N.J.A.C. 14:1-5.6(b), conveyances of utility property having a net book cost or fair market value greater than $500,000 shall be subject to public advertising, unless said property is conveyed for public utility purposes to another public utility or other person or company subject to any jurisdiction of the Board. The transfer of Bayside to TELP does not meet this exception. However, pursuant to N.J.A.C. 14:1-5.6(i), the Board may grant a waiver from the advertising requirement where all the conditions therein are met. By ACE's admission, the provision of N.J.A.C. 14:1-5.6(i)(6) has not been met, as ACE and TELP are affiliated entities, thereby establishing a relationship other than that of transferor and transferee. ACE seeks a waiver of the provision of this subsection, in addition to a waiver of the advertising requirement. Based upon the assertions made by ACE in its letter dated September 1, 2000, the Board

FINDS that, with the exception of the affiliate relationship between ACE and TELP, the Company meets all other relevant provisions for a waiver of the advertising requirements. The Board notes the Company's assertion that the transfer of the Bayside facility to TELP is intended to satisfy a provision in the Service Agreement whereby Conectiv will then be able to sell its thermal operations to an unaffiliated entity. The Board also notes that, while the Advocate acknowledges that the restrictions in the Service Agreement between ACE and NJSEA serve to limit the number of potential buyers, the Advocate argues that the Company should have sought a waiver of the Board's bid requirements prior to the initiation of the sale process. This argument notwithstanding, the Board notes that the Advocate does not oppose the transaction, acknowledging that the transaction would provide benefits to NJSEA, with little potential for benefit to customers if the transaction does not occur.

Based on its review of the submissions, the Board FINDS that a waiver of the advertising requirement will not affect the public interest because the proposed sale concerns non-utility assets used solely to provide thermal energy service to NJSEA. The Bayside facility has not been used for utility purposes, nor is there a prospective use of Bayside for utility purposes because the facility primarily consists of chillers and boilers used in providing thermal energy, which is an unregulated competitive service. Similarly, the sale of Bayside will not affect the ability of ACE to render safe, adequate and proper service. In addition, there appears to be no existing or prospective use of the property for utility purposes. Furthermore, the Board notes that, as discussed above, a number of unique circumstances exist in this case which mitigate in favor of waiving the advertising process. Specifically, the Board notes that: (1) Bayside was constructed solely to serve NJSEA; (2) the Service Agreement severely restricts the pool of prospective buyers to which the facility can be transferred without NJSEA's express consent; (3) there are restrictive attributes of the property, such as adjacent utility facilities and a roadway, which limit the potential of a prospective buyer for any other use; and (4) the selling price closely approximates the fair market value of the property to be sold based on an independent appraisal. Therefore, for the reasons stated above, and subject to the conditions noted below, the Board HEREBY GRANTS a waiver of the advertising requirement of N.J.A.C. 14:1-5.6(b) in this matter.

The Board also notes that, according to the letter petition, Bayside was originally designed and constructed in anticipation of providing a greater level of thermal services than has materialized to date. According to the independent appraisal submitted by ACE, Bayside has been operating at less than one-third of its design capacity. N.J.S.A. 48:3-55 provides that 50% of the net revenues of a competitive service utilizing utility assets are to be used to offset regulated rates. Since Bayside utilizes utility property for its operations, customers would be entitled to a sharing of any resultant net revenues. Based upon ACE's assertions, the potential profitability of Bayside has not materialized, thereby not affording any potential benefit to customers resulting from the facility's continued operation by the Company. N.J.S.A. 48:3-55 also provides that a public utility holding company may offer competitive services to retail customers of an electric utility, but only through a related competitive business segment that is neither an electric public utility or a related competitive business segment of the electric public utility. ACE's proposal to transfer the facility to TELP and to lease its utility property on which the facility is situated to TELP through the facility's useful life appear to to be consistent with these provisions. The Board therefore FINDS the transfer of Bayside from the Company to TELP to be consistent with N.J.S.A. 48:3-55 which allows for an electric public utility to transfer its competitive services to a related competitive business segment of a holding company, such as Conectiv, which is not itself an electric public utility or a related competitive business segment of the electric public utility.

The proposed transfer price is $3,499,000, equal to the net book value of Bayside. The independent appraisal provides a calculated value of $3,355,047 for the facility. The Board FINDS that the transfer price exceeds the independently appraised value and reasonably reflects the fair market value of the facility. The Board HEREBY APPROVES, subject to the conditions noted below, the transfer of the Bayside facility from ACE to TELP for $3,499,000.

The Board recognizes that the proposed pro forma accounting journal entries, as originally submitted as part of the letter petition, in accordance with N.J.A.C. 14:1-5.6(a)12, is inconsistent with the uniform system of accounts prescribed for electric utilities. The Board also recognizes that ACE subsequently remedied said journal entries and income statements to Staff's satisfaction. Based on the foregoing, the Board FINDS that the pro forma journal entries now accurately reflect the appropriate accounting treatment relating to the transfer of Bayside. The Board DIRECTS ACE to provide actual journal entries within forty-five (45) days of the completion of the transfer. The Board reserves its right to review these journal entries again in ACE's next base rate case or other appropriate proceeding.

Both the Assignment and Assumption Agreement and the Asset Transfer Agreement provide that the transfer of Bayside from ACE to TELP is contingent upon Board approval of the Lease Agreement for the utility property upon which the facility is situated. As ACE explained through discovery requests, the lease amount was determined by comparing the value of adjacent land that had actually been sold, thereby establishing a fair market value for the Bayside property. Based upon the Company's information, the actual lease rate is slightly above the fair market lease rate, which was calculated by multiplying the sales price per square foot by a commonly used annual lease factor multiplied by the number of square feet in the lease. The Board FINDS the monthly consideration of $3,750, or $45,000 per year, to be reasonable, given the process used to determine the lease rate and the fact that the property serves no practical purpose other than its current use. The Board further FINDS that, because the facility is located on utility-owned real property which has been supported by utility customers over the years, all revenues derived from said lease shall flow directly to the Company's customers, thereby providing an immediate benefit to customers by offsetting regulated rates. The Board therefore DIRECTS that all revenues earned from the lease shall be used, upon receipt by ACE, to immediately offset the Company's market transition charge ("MTC") assessed to customers. Based upon the foregoing findings, and subject to the conditions noted below, the Board HEREBY APPROVES the lease of the Company's property on which the facility is situated, to TELP in the annual amount of $45,000.

In approving the lease, the Board notes that, since October 29, 1993, when ACE and NJSEA entered into the Service Agreement, and for the period through the present time, customers have supported the property upon which the facility is situated through their utility rates, but have not received any financial benefit from Bayside's use of utility-owned property. Indeed, it appears that the encumbrance of the utility property for non-utility purposes was entered into contrary to the requirement of N.J.S.A. 48:3-7 and, pursuant to N.J.S.A. 48:3-55(h), said encumbrance constitutes an electric utility using regulated rates to subsidize its competitive services, since the real property on which Bayside is situated is included in ACE's base rates. Had the Company originally sought Board approval of the Service Agreement, the Board would likely have imposed a lease payment by ACE's shareholders to the benefit of the Company's customers for the use of the real property. In general terms, it is arguable that customers have foregone about seven years of unrealized lease income since 1993, while bearing the responsibility for taxes and other assessments related to the property. Going forward, customers can anticipate realizing over one million dollars in rental income through 2026, with TELP assuming responsibility for taxes and other assessments.

For the reasons set forth above, the Board conditions its approval of the transfer of Bayside and the related lease of utility property on which Bayside is situated, and the granting of a waiver of the Board's advertising requirement as follows. As a condition of its approval, the Board DIRECTS Staff to initiate informal discussions with ACE to resolve the remaining issue of whether the Company's customers are entitled to additional compensation for the prior use of the utility property for non-utility purposes. If Staff and the Company cannot informally resolve this issue in a timely manner, the Board DIRECTS Staff to return this matter to the Board's agenda for the initiation of a formal proceeding to consider this issue.

DATED: December 17, 2001

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)

FREDERICK F. BUTLER
COMMISSIONER

ATTEST: (SIGNED)

HENRY M. OGDEN
ACTING SECRETARY

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